Oil Prices Transforming Global Geopolitics

Political events can have a significant influence on the price of oil, but the price of oil also has a strong influence on political events. In 2016, the latter was in full force, with enormous geopolitical consequences from the downturn in the price of oil.

Low oil prices combined with other socio-economic factors have been responsible for devastating food shortages in Venezuela and an ongoing recession in Nigeria. Even in traditionally oil-rich countries such as Saudi Arabia, there have been cutbacks to public subsidies for water and electricity to counterbalance lost oil revenue.

With the advent of technological advancements in hydraulic fracturing (also known as “fracking”), the average breakeven price for **shale oil producers has fallen by more than 40%.**

The days when oil was selling at US$120 per barrel are long gone, with shale oil currently being extracted in US states such as North Dakota and Montana for as little as US$29 a barrel.

The US is set to surpass Saudi Arabia to **become the world’s leading source of oil** this year, which will re-shape the geopolitical landscape of the energy industry for years to come and impact any company that operates or invests in the affected countries.

2017 OIL AND GAS RISK-REWARD INDEX

Which oil-rich countries will be most affected by changes in the global economics of the oil industry? Marsh’s “2017 Oil and Gas Risk Reward Index” quantifies and ranks a country’s attractiveness within the context of the oil industry, based on the balance between the risks and rewards of entering and operating in different countries.

In this article, we examine six oil-rich countries that have the potential for long-term economic transformation that could impact international businesses, investors, and — of course — the energy industry. The report draws on data and insight from BMI Research — a leading source of independent political, macroeconomic, financial, and industry risk analysis — and from Marsh’s Political Risk Map 2017, which presents a global view of the issues facing multinational organisations and investors.

COUNTRIES TO WATCH

LIBYA

OIL AND GAS INDEX OUT OF 100:

30.1 (UNSTABLE)

COUNTRY RISK SCORE OUT OF 100:

31.0 (UNSTABLE)

Post-Qadhafi, Libya has been wracked by conflict between two rival governments. Given the high level of fragmentation, weak institutional capacity, and a chronic security vacuum, the operating environment will likely remain critically unstable in 2017. Due to deep divisions along multiple political, religious, and tribal lines, progress towards forming a unified government is slow. If the peace process collapses, the country's oil infrastructure would form a focal point for the conflict, which would disrupt both exports and revenues.

In December 2016, Libya set a goal to raise its oil production to 900,000 barrels per day (b/d) by reopening the Sharara and El Feel fields. However, recent history has shown that output can slump to as low as 50,000 b/d. Regardless of the outcome of the peace process, widespread damage to infrastructure and chronic underinvestment will continue to impact production, and it will therefore take time to raise output to a level significantly above the one million b/d mark. The country will retain several hallmarks of a failed state for some years to come.

SAUDI ARABIA

50.5 (STABLE)

63.8 (MODERATE STABILITY)

Saudi Arabia's economy continues to rely heavily on hydrocarbons, particularly crude oil. However, the extended period of low oil prices has, in part, prompted plans for a transformation within the country, involving large-scale fiscal consolidation and economic reforms. One aim of Deputy Crown Prince Mohammed bin Salman's "Vision 2030" is to wean the country off its overreliance on oil. Other reforms include increasing private-sector participation in the national petroleum and natural gas company, Saudi Aramco.

For the energy industry, these changes could mean an increase in oil prices. However, because much of the country's welfare subsidies are currently funded by oil, citizens could see cuts to counterbalance lost oil revenue in the future.

This would have major socio-economic repercussions over the coming decade, considerably heightening political risk in the kingdom. Over the short term, the regime will contain dissatisfaction by scaling back, modifying, or cancelling some reforms if they trigger too much instability.

NIGERIA

49.6 (MODERATE STABILITY)

47.5 (UNSTABLE)

Unrest in the oil-producing Niger Delta remains the starkest risk to Nigeria's hydrocarbon sector. Negotiations are ongoing between militant groups, Niger Delta leadership, and the Federal Government. Until a settlement is found, the threat of further attacks to energy infrastructure in Nigeria from militant groups, such as the Niger Delta Avengers and other smaller groups, remains high. The intensity of the 2016 attacks – and the inability of the government to thwart them – will live long in the memory of investors, leading to a loss of investment in Nigeria's hydrocarbon sector.

Production is forecasted to average 2.14 million barrels per day (b/d) this year, up from 1.8 million b/d in 2016. Rising oil revenues will help ease the current fuel shortage in the country. Several large final investment decisions (FIDs) are required to secure Nigeria's production in the long term; however, the likelihood of projects reaching FIDs in next two years has fallen sharply, which could lead to production declines post-2018. Should ongoing negotiations prove to be successful, it would enable oil production to recover.

Oil and Gas Risk Reward Index 2017
Source: BMI Research

< 29	30–39	40–49	50–59	60+

UNSTABLE ← → STABLE

Country Risk Score 2017
Source: BMI Research

<49	50–59	60–69	70–79	80–100

UNSTABLE ← → STABLE

IRAN

OIL AND GAS INDEX OUT OF 100:

42.7 (MODERATE STABILITY)

COUNTRY RISK SCORE OUT OF 100:

44.1 (UNSTABLE)

A more confrontational US foreign policy following Donald Trump's election as US President, and reciprocal action from Iran, could derail the Joint Comprehensive Plan of Action. As a result:

- Political jousting in the early months of 2017 could result in a build-up of political support for hardliners in Iran. As a consequence, relatively moderate President Hassan Rouhani could lose power to a less moderate candidate.
- The potential addition of new US sanctions on Iran, or the reintroduction of secondary sanctions, would make it more difficult for foreign companies to do business with the country.

The immediate impact would be oil-price supportive as Iran's oil production outlook weakens, but little is likely to change this year. No firm commitments have been made by foreign investors in Iran, despite cooperation memorandums. If this situation continues, Iran's medium-term oil outlook will deteriorate, as greater protectionism and less foreign investment would dent new projects.

Iran will hold presidential elections in May to determine whether Rouhani wins a second term. This will play an important part in determining whether or not Tehran preserves the landmark 2015 nuclear deal with the world's major powers.

VENEZUELA

25.6 (UNSTABLE)

37.6 (UNSTABLE)

Political risk in Venezuela remains severe amid an economic and political crisis, which is likely to reach a decisive turning point in 2017.

The high probability of Venezuela defaulting on its sovereign debt obligations is a key risk. A sovereign default would force substantial policy adjustments and likely catalyse a change in administration. Meanwhile, the challenging operating environment for state-run oil company PdVSA is nearing the breaking point under the weight of long-standing inefficiencies and sustained commodity price weakness. The combination of prolonged output declines and an inadequate rise in oil prices would leave PdVSA struggling to pay its next large tranche of debt obligations.

A default would constrain finances within the sector even more, exacerbating output declines in 2017. As the operator and largest stakeholder in all oil projects in the country, PdVSA's lack of financing would increase pressure on private-sector participants to generate output, particularly from heavy oilfields in the Orinoco region. However, the majority of companies committing funds this year would likely withdraw, resulting in more rapid production declines throughout the country.

INDONESIA

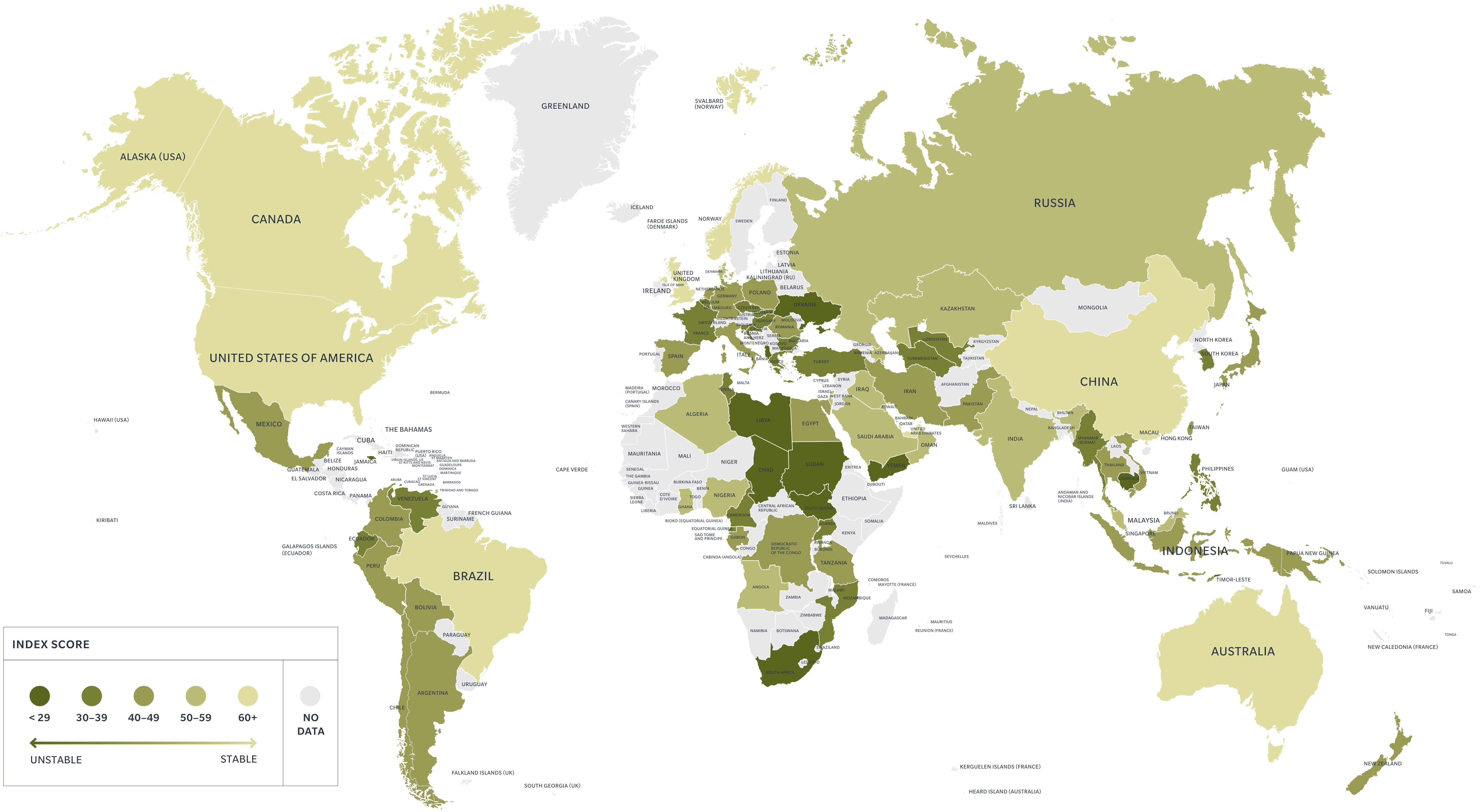
45.9 (MODERATE STABILITY)

61.7 (MODERATE STABILITY)

A growing sense of nationalism in the Indonesian upstream segment poses a major risk to its long-term production growth outlook and could severely reduce the country's attractiveness as a destination for private and foreign investments. Investors are unlikely to be enthused by the country's more nationalistic oil and gas law, introduced last year, which will provide further preferential treatment for state-owned Pertamina. Private participation in exploration and production will be restricted under a cooperation agreement with a newly formed state-owned entity, BUMN-K.

Furthermore, the law does not provide clear-cut guidelines on several key mechanisms, including cost recovery and production-sharing, which will negatively impact investor sentiment. In the downstream space, private firms will be able to conduct business as usual, with relevant government-issued licenses. However, the new law calls for a new downstream operator, BUP, to centralise the compulsory sale and purchase of oil and gas production for domestic consumption.
All downstream firms will now be required to sell substantial parts of their fuels output to BUP.

UPSTREAM OIL AND GAS RISK REWARD INDEX 2017



ASSESSING THE IMPACT OF GEOPOLITICAL RISKS IN THE OIL AND GAS SECTOR

As a result of the challenges faced by countries detailed in this report, as well as those by other countries featured in our 2017 Oil and Gas Risk-Reward Index, greater consideration should be given to the risks of operating in the oil and gas industry in these regions and/or how it could impact a company's overall supply chain. The impact of lower prices, succession risks, socio-economic challenges, and business interruption as a result of political tensions on a multinational energy organisation has never been more important to assess.

In addition, multinational organisations with significant holdings in countries that have a high reliance on oil and gas revenue should be aware of how oil prices can influence political risks, and take this into consideration when developing business continuity plans.

ABOUT THE OIL & GAS RISK REWARD INDEX

Drawing on data from BMI Research, the Upstream Oil & Gas Risk Reward Index quantifies and ranks a country's attractiveness within the context of the oil industry, based on the balance between the risks and rewards of entering and operating in different countries. The index combines industry-specific characteristics with broader economic, political, and operational market characteristics.

Inputs are weighted in terms of their importance to investor decision making in a given industry. The result is a nuanced and accurate reflection of the realities of operating/investing in each country, based on the balance between opportunities and risk, and between sector-specific and broader market traits.

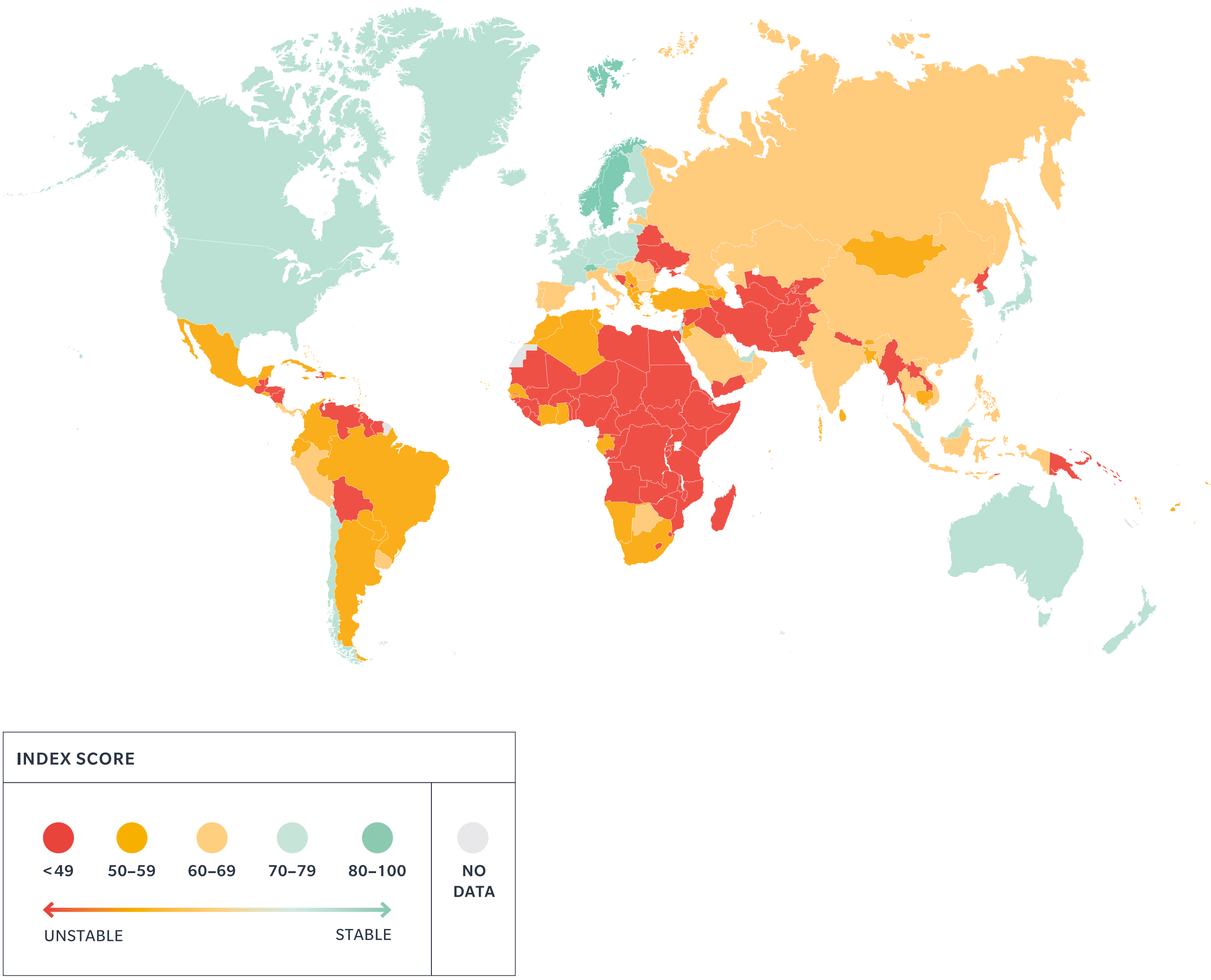
For more information on BMI Research visit bmiresearch.com

POLITICAL RISK MAP 2017

Marsh's "Political Risk Map 2017" presents a global view of issues facing multinational organisations and investors, drawing on data and insight from BMI Research.

Explore the map to view risk scores for the countries where you may have assets, operations, or investments, or may be considering new opportunities. Choose the overall "Country Risk Index," or view the map by in-country political, economic, or operational risk scores.

To view the interactive map visit marsh.com



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